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Zirkelbach Construction, Inc. v. DOWL, LLC dba DOWL HKM: Do Parties Have the Freedom to Contractually Limit their Liability?

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**PRECAP; Zirkelbach Construction, Inc. v. DOWL, LLC dba
DOWL HKM: Do Parties Have the Freedom to Contractually Limit
their Liability?**

Jennifer Shannon

ORAL ARGUMENT is set for Wednesday, July 12, 2017, at 9:30 a.m. in the Courtroom of the Montana Supreme Court, Joseph P. Mazurek Building, Helena, Montana.

I. QUESTION PRESENTED

Can two sophisticated entities contract to limit liability for consequential damages?

II. INTRODUCTION

Appellant Zirkelbach paid over \$1,000,000 to fix the mistakes of their subcontractor, Appellee DOWL.¹ When Zirkelbach attempted to recover for DOWL's negligence, the District Court held a clause in the parties' contract limited DOWL's liability to \$50,000.²

On appeal, Zirkelbach argues that the limitation of damages constitutes an illegal exculpatory clause, which Montana's courts have a long history of prohibiting.³ Zirkelbach contends that allowing DOWL to limit their liability would effectively permit DOWL to contract away repercussions for their negligence.⁴ Zirkelbach also maintains that the clause is ambiguous and therefore should be disregarded.⁵ DOWL argues on appeal that their clause simply limits a part of liability, and therefore is not exculpatory.⁶ DOWL contends that this kind of clause is not only enforceable, but common between two sophisticated entities—such as Zirkelbach and DOWL—who have the freedom to contract.⁷ Ultimately, the Court must decide on appeal whether the freedom to contract extends to a party's ability to limit their own liability to a minimal amount of their foreseeable damages.

¹ Appellant's Opening Brief at 2, *Zirkelbach Construction, Inc. v. DOWL, LLC dba DOWL HKM*, <https://perma.cc/5UQY-WLTL> (Mont. Feb. 27, 2017) (No. DA 16-0745).

² *Id.* at 6.

³ *Id.* at 7–12.

⁴ *Id.* at 13.

⁵ *Id.* at 24.

⁶ Appellee's Brief at 15, *Zirkelbach Construction, Inc. v. DOWL, LLC dba DOWL HKM*, <https://perma.cc/PXU6-QHR4> (Mont. Mar. 29, 2017) (Do. DA 16-0745).

⁷ *Id.* at 21.

III. FACTUAL BACKGROUND

This case arises out of the construction of a FedEx Ground facility in Billings, Montana.⁸ SunCap, the property owner, hired Zirkelbach as the general contractor for the project.⁹ Zirkelbach subsequently entered into a contract (the “Agreement”), with DOWL, a professional design company, to provide design work for the facility.¹⁰

The Agreement was a form contract provided by DOWL and amended by the parties.¹¹ The Agreement stipulated that Zirkelbach would act as the general contractor and DOWL would provide the services of “Design Professionals,” including final design, road improvements, on-site and off-site construction administration, and material testing.¹² The Agreement also contained the following clause:

“Consequential Damages/Limitation of Liability. To the fullest extent permitted by law, DOWL HKM and Client waive against each other, and the employees, officers, directors, agents, insurers, partners and consultants, any and all claims for or entitlement to special, incidental, indirect or consequential damages arising out of, resulting from, or in any way related to the Project, and agree that DOWL HKM’s total liability to Client under this Agreement shall be limited to \$50,000.00.”¹³

DOWL’s total fee under the contract, including amendments, totaled over 600,000.¹⁴

DOWL, however, did not complete the work to Zirkelbach’s or FedEx’s standards.¹⁵ In their brief, Zirkelbach asserts over \$1,000,000 in damages it suffered due to DOWL’s mistakes on multiple components of the facility’s design.¹⁶

Originally, a third party sued Zirkelbach for unpaid construction liens.¹⁷ Zirkelbach added DOWL in a third party complaint, alleging negligence and breach of contract and seeking recovery for the substantial damages they incurred while fixing DOWL’s mistakes.¹⁸ DOWL filed a motion for partial summary judgment, asking the court to uphold the Agreement’s limitation of liability clause.¹⁹ The Court granted the

⁸ Appellant’s Opening Brief, *supra* note 1, at 1.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at 3.

¹³ *Id.* at 2.

¹⁴ Appellant’s Opening Brief, *supra* note 1, at 2.

¹⁵ *Id.* at 4–5.

¹⁶ *Id.* at 5.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 5–6.

motion.²⁰ After being denied certification of a final judgment, Zirkelbach filed this appeal.²¹

IV. SUMMARY OF ARGUMENTS

A. Appellant Zirkelbach

1. Enforcement of the limitation of liability clause runs counter to Montana Statute and public policy.

Zirkelbach first argues that the District Court erred by upholding DOWL’s limited liability clause because only under a “strained and inaccurate” reading of Montana law could such a clause be valid.²² Montana Code Annotated section 28–7–202 provides that any contract which directly or indirectly exempts anyone from responsibility “for the person’s own fraud, for willful injury to the person or property of another, or for violation of the law, whether willful or negligent,” is against public policy.²³ Zirkelbach maintains that the Court’s interpretation of this statute provides that any attempt to limit one’s liability to a nominal amount—as DOWL’s clause does—is invalid.²⁴

Turning to the clause itself, Zirkelbach provides two reasons why Montana’s statutory bar on exculpatory clauses must apply.

Zirkelbach first argues that under California’s *Tunkl*²⁵ test, limitation of liability to a nominal amount—here, less than 1/13th of DOWL’s professional fee and less than 1/24th of the damages Zirkelbach suffered—is exculpatory and therefore invalid.²⁶ In *Tunkl*, the plaintiff signed a form when entering a hospital that released his doctors from any liability.²⁷ The Court held that this kind of clause represented an unenforceable exculpatory clause.²⁸ The Court then provided a six-factor test for determining if a clause was exculpatory: 1) The contract involves a business suitable for regulation; 2) The contracting party performs a service of great importance to the public, often a practical necessity for some; 3) The party holds itself out as willing to perform services for anyone willing to seek it; 4) There is an essential need for the party’s services which gives it a decisive bargaining power; 5) This superior bargaining power results in a standard contract of adhesion with

²⁰ Appellant’s Opening Brief, *supra* note 1, at 6.

²¹ *Id.*

²² *Id.* at 8.

²³ Mont. Code Ann. § 28–7–202 (2015).

²⁴ Appellant’s Opening Brief, *supra* note 1, at 8–11.

²⁵ *Tunkl v. Regents Univ. of Cal.*, 383 P.2d 441 (Cal. 1963).

²⁶ Appellant’s Reply Brief at 2, *Zirkelbach Construction, Inc. v. DOWL, LLC dba DOWL HKM*, <https://perma.cc/8HFN-QEUV> (Mont. Apr. 7, 2017) (No. DA 16-0745).

²⁷ *Tunkl*, 383 P.2d at 442.

²⁸ *Id.* at 447.

exculpation: and, 6) The resulting contract gives the seller control over the buyer.²⁹

Zirkelbach argues that most, if not all, of these factors describe DOWL's clause.³⁰ First, DOWL was to perform "professional services," which under the industry definition include state-regulated professions.³¹ Second, Zirkelbach opines, DOWL was in the business of designing safe buildings, which is of great importance to both general contractors and the individuals who end up working in DOWL's building.³² To the third factor, Zirkelbach only suggests that "DOWL obviously offers its professional services to anyone who needs them and is willing to pay."³³

Zirkelbach threads together similar arguments to prove the final three *Tunkl* factors, and these arguments prove the most contentious. Zirkelbach argues that it was "obligated" by SunCap to utilize DOWL, in that SunCap specifically directed Zirkelbach in their contract to hire DOWL.³⁴ Zirkelbach contends that the inability to choose a design company gave DOWL significant bargaining power, despite both parties being sophisticated entities.³⁵ With this control, Zirkelbach argues the Agreement was a contract of adhesion and the limitation of liability clause was exculpatory.³⁶

Zirkelbach's second argument that the clause is exculpatory maintains that the \$50,000 limitation is so minimal that it rids DOWL's incentive to perform professionally.³⁷ Zirkelbach maintains that the limitation, when compared to the foreseeable damage and contracting fee, is nominal.³⁸ Zirkelbach warns that allowing such nominal liability limitations leaves no "skin in the game" for professional companies such as DOWL, who can perform however they like with little repercussion.³⁹ This, Zirkelbach contends, is against public policy.⁴⁰

2. *Under Montana law regarding contract interpretation, the language of the parties' contract was ambiguous, and therefore the limitation of liability clause should be void.*

Zirkelbach also argues that the Court should not uphold the limitation of liability clause because the clause and the contract are

²⁹ *Id.* at 444–445.

³⁰ Appellant's Opening Brief, *supra* note 1, at 16.

³¹ *Id.*

³² *Id.* at 17.

³³ *Id.* at 18.

³⁴ *Id.*

³⁵ *Id.*

³⁶ Appellant's Opening Brief, *supra* note 1, at 18–19.

³⁷ *Id.* at 21.

³⁸ *Id.* at 24.

³⁹ *Id.* at 23.

⁴⁰ *Id.* at 21.

ambiguous.⁴¹ Montana courts have held that a contract is ambiguous if “the language is susceptible to at least two reasonable but conflicting meanings,” based upon the understanding of the parties at the time of contracting.⁴²

Zirkelbach first argues that the limitation clause is ambiguous.⁴³ Specifically, Zirkelbach contends that the clause lacks clarity as to whether the limitation applies to all liability or only to liability for consequential damages; this ambiguity is due to conflicts between the clause’s title and its actual contents.⁴⁴ Because there are two reasonable interpretations of this clause, Zirkelbach argues, the clause must be resolved in its favor.⁴⁵

Further, Zirkelbach maintains, when examining the whole of the contract, the clause is ambiguous.⁴⁶ As evidence of this ambiguity, Zirkelbach points to contractual clauses which provide for professional liability insurance and communications between the parties regarding indemnification.⁴⁷ This evidence, Zirkelbach provides, makes the limitation of consequential damages ambiguous.⁴⁸

B. Appellee DOWL

1. *The District Court properly held that the limitation of liability clause clearly and unambiguously limits DOWL’s potential liability to \$50,000.*

DOWL argues that the District Court properly upheld its limitation of liability clause because it is unambiguous.⁴⁹

DOWL contends Zirkelbach’s ambiguity argument fails for three reasons: first, Zirkelbach did not argue ambiguity at the District Court level; second, the clause itself is clear and unambiguous; and third, the addendums, amendments, and emails are unambiguous.⁵⁰ DOWL highlights that the Court must not overstep its boundaries by attempting to interpret the Agreement, which was carefully and freely crafted between two sophisticated entities.⁵¹

DOWL first contends that Zirkelbach never argued the contract was ambiguous before the District Court, which prevents Zirkelbach from raising ambiguity on appeal.⁵² In the appellant’s reply brief, Zirkelbach

⁴¹ *Id.* at 24.

⁴² Appellant’s Opening Brief, *supra* note 1, at 25 citing *Mary J. Baker Revocable Trust v. Cenex Harvest States, Coops.*, 164 P.3d 851 (Mont. 2007).

⁴³ *Id.* at 27–28.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.* at 29.

⁴⁷ *Id.* at 29–34.

⁴⁸ Appellant’s Opening Brief, *supra* note 1, at 34.

⁴⁹ Appellee’s Brief, *supra* note 6, at 9.

⁵⁰ *Id.* at 9–15.

⁵¹ *Id.* at 7–8.

⁵² *Id.* at 9–10.

contends that ambiguity was raised by the District Court in its Memorandum and Order granting the motion for partial summary judgment, giving Zirkelbach the power to argue ambiguity on appeal.⁵³

Second, DOWL refutes Zirkelbach's argument that the clause itself is ambiguous.⁵⁴ DOWL contends that the clause's title—Consequential damages/Limitation of Liability—clearly provides that consequential damages are limited under it. Further, DOWL argues that Zirkelbach's reading of the clause ignores the "ordinary rules of grammar."⁵⁵

Finally, DOWL argues that the contract as a whole is unambiguous.⁵⁶ They cite that professional liability insurance is often used to insure third parties, and the communications about indemnification provided by Zirkelbach were not regarding liability indemnification.⁵⁷

2. *The limitation of liability clause is enforceable because it complies with Montana law and public policy.*

DOWL also argues that the clause must be upheld because it is not exculpatory.⁵⁸ DOWL again highlights that the Agreement was drafted between two sophisticated entities with the freedom and ability to contract.⁵⁹

DOWL first contends that Zirkelbach failed to demonstrate that the limitation of damages clause is exculpatory.⁶⁰ DOWL contends that the clause is instead a limitation of liability clause, which, unlike the exculpatory clauses Montana law rejects, does not completely eliminate liability.⁶¹ Zirkelbach's arguments regarding exculpatory clauses, therefore, do not apply.⁶²

In fact, DOWL opines, limitation of liability clauses only seek to limit a specific type of liability.⁶³ And, DOWL contends, a majority of jurisdictions including Montana have upheld limited liability clauses where, as here, they are made between two sophisticated entities.⁶⁴ Even further, DOWL maintains that many of these jurisdictions have found that caps similar to the \$50,000 DOWL provided are not "nominal."⁶⁵ As the cap is not nominal, DOWL provides that design companies like itself

⁵³ Appellant's Reply Brief, *supra* note 26, at 11.

⁵⁴ Appellee's Brief, *supra* note 6, at 10–12.

⁵⁵ *Id.*

⁵⁶ *Id.* at 12.

⁵⁷ *Id.* at 13–15.

⁵⁸ *Id.* at 15.

⁵⁹ *Id.* at 21–23.

⁶⁰ Appellee's Brief, *supra* note 6, at 15.

⁶¹ *Id.* at 16.

⁶² *Id.* at 15.

⁶³ *Id.* at 16.

⁶⁴ *Id.* at 17–20, 24 n.5.

⁶⁵ *Id.* at 25.

would not be excused from incentive to perform professionally if the court upheld the limitation of liability clause.⁶⁶

Thus, DOWL returns to the central tenant of its argument: that Zirkelbach, a sophisticated entity, knowingly negotiated and entered into the Agreement.⁶⁷ DOWL points out that Zirkelbach is a large corporation that does business all over the United States and has both national and multi-national clients such as FedEx.⁶⁸ Further, DOWL argues, the District Court found that both DOWL and Zirkelbach are sophisticated entities.⁶⁹ Specifically, DOWL contends that Zirkelbach was not required by SunCap to contract with DOWL, but instead that SunCap merely suggested Zirkelbach engage with DOWL.⁷⁰ Without this required use, and with the established equality of bargaining between the parties, DOWL argues that a limitation of liability clause—such as the clause in the Agreement between DOWL and Zirkelbach—is enforceable.⁷¹

Second, DOWL argues that *Tunkl* simply cannot apply to this case.⁷² Where *Tunkl*'s story regards an exculpatory clause made for a patient to exclude all liability of a hospital, DOWL argues the clause in this case is far from similar.⁷³ In fact, DOWL contends that the California Supreme Court noted that the result in *Tunkl* would have been different if two private entities had negotiated to shoulder a liability.⁷⁴ Thus, DOWL argues, *Tunkl* is inapplicable.⁷⁵

V. ANALYSIS

This case places the Montana Supreme Court at the confluence of two important and long-standing traditions in Montana law—freedom to contract⁷⁶ and the prohibition of limiting one's own liability.⁷⁷

The Court may find that DOWL has a more persuasive argument because sophisticated entities should be able to freely contract without the court's interference. This ruling would be in line with Montana's tradition of allowing freedom to contract.⁷⁸ Indeed, if the Court rules in favor of DOWL, parties will simply be held accountable for what they negotiate and agree to in a written contract.

⁶⁶ Appellee's Brief, *supra* note 6, at 27.

⁶⁷ *Id.* at 21–23.

⁶⁸ *Id.* at 2.

⁶⁹ *Id.* 21.

⁷⁰ *Id.* at 22.

⁷¹ *Id.* at 23.

⁷² Appellee's Brief, *supra* note 6, at 27.

⁷³ *Id.* at 27–28.

⁷⁴ *Id.* at 28.

⁷⁵ *Id.* at 29.

⁷⁶ See e.g., *Arrowhead Sch. Dist. No 75 v. Klyap*, 79 P.3d 250 (Mont. 2003).

⁷⁷ See e.g., *Miller v. Fallon County*, 721 P.2d 342 (Mont. 1986).

⁷⁸ See e.g., *Arrowhead*, 79 P.3d 250.

On the other hand, Zirkelbach has a strong argument from a public policy standpoint that allowing parties to limit their own liability would effectively eliminate the incentive to perform professionally. Indeed, if the Court allows DOWL's limitation, anyone will be able to limit liability for their own negligent acts.

However, given the freedom to contract, these negative ramifications of ruling in DOWL's favor could be eliminated if parties simply remove limitation of liability clauses during negotiations. This will be particularly possible in contracts between two sophisticated entities, and the Court could limit their holding to apply only to contracts between these kinds of parties.

In weighing these arguments, the Court may also consider *Tunkl*, which was relied upon heavily by Zirkelbach. However, DOWL appears to have the more persuasive argument against using this case, as the facts in *Tunkl* are highly distinguishable. This is particularly true because Zirkelbach's argument on *Tunkl* does not firmly show the Court how *Tunkl*'s contract with a hospital for necessary medical services is the same as a contract between two private companies. If, however, the Court decides *Tunkl* is applicable, the determinative fact will likely be whether SunCap required Zirkelbach to hire DOWL.

No matter how the Court rules, it will be defining an exculpatory clause. If the Court rules in favor of Zirkelbach, clauses that limit liability to a "nominal" amount become exculpatory. If, however, it rules in favor of DOWL, the line between a limitation of liability clause and an exculpatory clause will remain blurred. To defend a decision in favor of DOWL, the Court will likely have to define what it is about DOWL's clause that makes it a limitation of liability, and therefore not exculpatory.

Indeed, the Court can avoid the issue of defining the role of limited liability clauses in Montana jurisprudence if it finds the clause, or the contract as a whole, is ambiguous. It is more likely, however, that the issue of ambiguity will not be the deciding issue in this case.

At oral argument, the parties will likely attempt to define an exculpatory clause. The Court will likely ask Zirkelbach why *Tunkl* should apply, and the Court's questions for DOWL will likely center around DOWL's true intentions of including the limitation of damages clause. Ultimately, the Court's holding will determine to what extent parties can freely contract away their liability.